

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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OFFICE OF SECRETARY

In the Matter of)

Policy and Rules Concerning Rates)
for Dominant Carriers)

Revisions to Price Cap Rules for)
AT&T)

CC Docket No. 87-313

CC Docket No. 93-197

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COMMENTS

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SUMMARY

The Commission should be commended for reexamining AT&T's price cap rules to assure that they continue to achieve the Commission's objectives and serve the public interest. The Commission should not focus on a transition to further streamlining the regulation of AT&T's services but rather on insuring that its rules serve the transition to effective and substantial competition that would ultimately make such rules unnecessary.

Price cap rules are interrelated and thus must be considered in their entirety to determine if the system of rules provide the incentives intended by the Commission. For this reason, the broad review commenced by the Commission is both necessary and appropriate.

The Commission proposes to amend AT&T's price cap rules regarding exogenous cost changes in the same manner that the LEC price cap rules were recently modified. BellSouth believes such a modification is appropriate because there is no basis for the Commission to employ a different standard for AT&T regarding exogenous cost changes than the standard applied to local exchange carriers.

Modification of the exogenous rules represents only a partial step in buttressing the foundation of AT&T's price cap rules. Before the Commission can seriously consider modifying AT&T's Basket 1 structure or the residential index, it must be certain that the price cap index (PCI) is properly specified. This requires that the PCI incorporate

the appropriate productivity offset.

In the LEC price cap review, the Commission, *sua sponte*, found that a 4.3 productivity (without sharing) offset was appropriate for LEC interexchange services. AT&T can achieve substantially greater productivity gains than local exchange carriers in the provision of interexchange services. In these circumstances there is no rational basis for the continuation of the 3.0 productivity factor for AT&T. Furthermore, until the proper productivity offset is established for AT&T, the Commission cannot consider modification of other elements of AT&T's price cap plan.

If the Commission makes the appropriate foundation changes to AT&T's price cap rules, then improvements on the Basket 1 rules can be made. In making any changes to the Basket 1 structure, the Commission should be guided by the fact that AT&T occupies a unique position in the marketplace. It operates in a market that has *de jure* barriers to entry that protect AT&T from competition from the most formidable potential competitors, the former Bell operating companies.

BellSouth proposes several modifications to the Basket 1 structure that would improve the efficiency of AT&T's price cap rules. BellSouth's proposed modifications would provide AT&T additional flexibility, yet, provide a reasonable price cap structure that recognizes AT&T's dominance in the marketplace. Accordingly, BellSouth's

proposals balance AT&T's interests and consumers' interests and would establish a congruent set of price cap rules that would further the public interest.

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COMMENTS

BellSouth Telecommunications Inc., ("BellSouth") hereby submits the following comments on the Commission's Further Notice of Proposed Rulemaking ("FNPRM") in the above referenced proceeding.

I. INTRODUCTION

In this proceeding, the Commission intends to further examine the regulations that pertain to AT&T's services that are still subject to price cap regulation. Among other things, the Notice consolidates issues concerning the treatment of promotional offerings and optional calling plans ("OCPs") into this proceeding. As the Commission points out, this Notice goes beyond the scope of earlier proceedings and examines a broader range of issues.¹

The Commission should be commended for reexamining AT&T's price cap rules to assure that they continue to achieve the Commission's objectives and serve the public interest. As the Commission correctly observes, price

¹ FNPRM at ¶ 2.

regulation "is designed to mirror the efficiency incentives found in competitive markets and acts as a transitional regulatory scheme until the advent of substantial competition makes price cap regulation unnecessary."² Accordingly, the Commission should not focus on a transition to further streamlining the regulation of AT&T's services but rather on insuring that its rules serve the transition to effective and substantial competition that would ultimately make such rules unnecessary.

Ultimately, the test against which any adjustment must be measured is the benefit to consumers. The price cap rules in their entirety ought to provide the type of incentives for AT&T to be more productive and for all consumers to benefit from price caps.

**II. THE APPROPRIATE PRICE CAP FOUNDATION
MUST BE IN PLACE BEFORE THE COMMISSION
CAN PROVIDE AT&T WITH ADDITIONAL FLEXIBILITY**

Price Cap rules are interrelated and thus must be considered in their entirety to determine if the system of rules provide the incentives intended by the Commission. For this reason, the broader review instituted by the Commission in this proceeding is both necessary and appropriate.

² Id. at ¶ 3.

In the FNPRM, the Commission proposes to amend AT&T's price cap rules regarding exogenous cost changes in the same manner that the LEC price cap rules were recently modified.³ In the LEC Price Cap Performance Review Report and Order, the Commission narrowed the scope of accounting changes that would be permitted to be reflected as exogenous to those that result in economic cost changes.⁴ In making this modification, the Commission believed it maintained "the best balance between promoting efficiency incentives and ensuring that the price cap formula does not lead to unreasonably high or low rates."⁵

The balance the Commission believes is appropriate to guide LEC price cap rules is equally applicable to AT&T. There is nothing that would make these principles applicable only to the LEC segment of the industry. To the contrary, the balance the Commission seeks to strike represents the core objective of price cap regulation and pertains to AT&T and LECs alike.

Equally compelling is the Commission's conclusion in the LEC Price Cap Performance Review Report and Order that the pricing flexibility afforded by price caps allows rates

³ Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, First Report and Order, FCC 95-132, released April 7, 1995. (hereinafter "LEC Price Cap Performance Review Report and Order").

⁴ Id. at ¶ 306.

⁵ Id. at ¶ 293.

to be adjusted to track economic cost changes and to respond to competitive challenges.⁶ Thus, in the Commission's view, the need for the LECs to have a mechanism to adjust for accounting cost changes, which has its roots in rate-of-return regulation, is tenuous. In the case of AT&T, it is non-existent. There is simply no basis to employ a different standard to AT&T regarding exogenous treatment of accounting changes than the economic cost standard the Commission adopted for the LECs.

In applying this standard to AT&T, it should follow the same approach to implementation that the Commission is employing with the LECs. Thus, the modification should be applied on a prospective basis. As in the case of the LECs, AT&T should be required to adjust its PCI prospectively to exclude the effects of any accounting cost changes currently reflected in the PCI for which AT&T did not incur an economic cost change.⁷

In addition, the Commission should adopt the same procedural measures as those adopted in the LEC Price Cap Performance Review Report and Order. The procedural vagueness identified by the Commission in the LEC price cap

⁶ Id. at ¶ 299.

⁷ In the LEC Price Cap Performance Review Report and Order, the Commission noted the most significant examples of accounting changes that would be effected by the new rule are those associated with the implementation of that Statement of Financial Accounting Standards Nos. 106 and 112.

review regarding the determination of whether exogenous treatment should be granted pertains equally to the rules that apply to AT&T. Accordingly, the Commission should remedy "the procedural lacuna" that remains in place for AT&T.

Modification of the exogenous rules represents only a partial step in buttressing the foundation of AT&T's price cap rules. Before the Commission can seriously consider modifying AT&T's Basket 1 structure or the residential index, it must be certain that the price cap index (PCI) is properly specified. This requires that the PCI incorporate the appropriate productivity offset. Recent Commission action in the LEC Price Cap Performance Review Report and Order establishes that the current 3.0 productivity factor applied to AT&T's Basket 1 services is too low and should be substantially higher.

When the Commission extended price cap regulation to the LECs, the Commission determined that the measures of LEC productivity were not applicable to LEC interexchange services and concluded that application of the AT&T productivity factor was a more appropriate measure.⁸ In the LEC Price Cap Performance Review Report and Order, the Commission's productivity analyses paralleled the analyses conducted in the original proceeding. Specifically, the

⁸ Policies and Rules Concerning Rates for Dominant, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786 (1990).

short term study focused on access service. Because the productivity measure of 5.3 was in part based on the short term study it is inapplicable to LEC interexchange services. Nevertheless, the Commission increased, *sua sponte*, the productivity factor applicable to LEC interexchange services to 4.3 without sharing.

Thus, the Commission's productivity factor of 4.3 for interexchange services should clearly be applied to AT&T's Basket 1 services. Without question, AT&T can achieve substantially greater productivity gains than LECs in the provision of interexchange services. AT&T's traffic volumes are increasing (at a faster rate than the LECs) and its share of the interexchange market has stabilized. These increased traffic volumes increase the efficiency of AT&T's network.

Unlike the LECs who are judicially constrained to short haul interexchange traffic, the preponderance of AT&T's traffic is long-haul in nature. This enables AT&T to employ in its network large capacity facilities and achieve economies of scale and scope unattainable by LECs. Simply put, there is no rational basis for the continuation of 3.0 productivity factor for AT&T. The Commission's action in the LEC price cap review compel an immediate adjustment to AT&T's productivity factor.

Until a proper productivity offset is established for AT&T, the Commission cannot consider modification of other

elements of AT&T's price cap plan. Accordingly, the Commission should issue an immediate, interim productivity offset prescription for AT&T set at 4.3. The Commission can then open a further proceeding to examine a permanent productivity measure based on publicly available and verifiable data. Indeed, the Commission should employ the same methodologies in determining AT&T's permanent productivity factor that it will use to determine the LEC's productivity factor.⁹

III. WITH THE APPROPRIATE FOUNDATION CHANGES,
REVISIONS TO THE AT&T PRICE CAP PLAN
SHOULD BE MADE

Given the appropriate foundation changes, then improvements can be made to the AT&T price cap rules that will enhance their efficiency and better serve the Commission's public policy goals. The modifications, however, must reflect the unique position that AT&T occupies in the marketplace. Today, AT&T operates in a market that has de jure barriers to entry that protect AT&T from competition from the most formidable potential competitors, the RBOCs. Accordingly, AT&T can and does dominate the

⁹ In its Petition for Reconsideration of the LEC Price Cap Performance Review Report and Order, AT&T has argued that changes in cost of capital should be reflected in required adjustments to price cap indices. In the event the Commission follows the type of approach advocated by AT&T in the LEC proceeding, it should likewise use the same methodology here. See AT&T Petition for Limited Reconsideration or, In the Alternative, Clarification, filed May 19, 1995 in CC Docket No. 94-1.

residential interexchange market.

Despite claims of robust competition, AT&T has been able to raise prices of its basic MTS rate schedule with impunity. AT&T's most significant competitors move their prices in lock-step with AT&T. Such parallel behavior evidences a continued need for Commission surveillance of the residential interexchange market to assure that consumers receive the benefits of productivity increases and efficiency gains such as reductions in access charges.

While modifications to the price cap rules can improve efficiency, the Commission is correct in its tentative conclusion not to remove promotions or Optional Calling Plans (OCPS) from price caps. Instead, the solution is the formulation of a congruent set of rules that govern the Basket 1 services that are applied consistently.

The Commission's past treatment of promotions and its proposals here exemplify a fragmented treatment of issues. In these instances, the Commission disregards the framework of price caps and branches-off to create special solutions. The better approach is to determine how the existing framework operates on a particular issue and make a change only if there is an unintended result.

The Commission, in this proceeding, is on a mistaken track. It is trying to define promotional offerings in anticipation that promotions can be treated singularly with some set of rules that will function efficiently. It misses

the fact that there is an operational framework that exists under price caps that has worked for the LECs and for the most part has worked for AT&T. In the case of promotional offerings it has been misapplied.

The price cap framework consists of pricing rules for new services, existing services and restructured services. In the past, promotions were treated by the Commission as rate changes for existing services. In this proceeding the Commission attempts to define a new category of promotions, alternative pricing plans, as self-selected promotions and proposes to create a set of rules applicable to this group. What is missed is that a promotion can be a new service, a restructure or a rate change depending on the design of the promotion.

Rather than trying to define a new category, the existing rules should be applied on a consistent basis. Thus, if the promotion is associated with the basic MTS schedule, then it should be treated as a new service, restructure or rate change associated with the basic MTS service category. Likewise, if the promotion is associated with an OCP, then it should be treated as a new service, restructure or rate change in connection with the OCP service category.

If a promotion is a new service, then forecasted demand and incremental costs should be submitted to support the

promotion.¹⁰ The promotion would, in accordance with existing rules be brought into the index following completion of the base year in which the new service was introduced. If the promotion is discontinued prior to the completion of the base period, the new service would not be incorporated into the index. If the promotion is a rate change, then base period historical demand should be used to estimate the impact on the API and any SBI requirements that are established. For a restructure, base period demand should be recast to the new rate structure.

The approach outlined above assures that the rules are applied consistently. It avoids the regulatory gaming that would be encouraged by preferential treatment being afforded a "defined" class of promotions. Finally, and perhaps most importantly, it would mean that index changes (APIs and SBIs) would be calculated on a uniform basis and thereby making them less susceptible to miscalculation.

While BellSouth does not support the creation of a new category of promotions, it does concur with the Commission that it is appropriate at this time to review the Basket 1 service category structure. Certainly, if the Commission undertakes to revitalize the foundation of the AT&T price

¹⁰ The Commission has suggested that promotions that are new services should be subject to a shortened notice period. See FNPRM ¶ 48. BellSouth has no objection to a short notice period, such as fourteen days, provided that the new service is filed with appropriate supporting information such as demand forecasts and incremental costs.

cap rules by changing the exogenous rules and retargeting the productivity factor, then the basket structure should be updated as well.

Restructuring the Basket 1 service categories should have the effect of affording AT&T additional pricing flexibility. One change that would have this result would be to combine into a single service category band, all domestic basic schedule MTS rates (including promotions for basic schedule services). This proposal would eliminate the separate categories that currently exist for each time-of-day rate period. Time-of-day pricing is often used to spread demand away from peak periods. It happens, on occasion, that such pricing can result in changing the peak period. Accordingly, greater flexibility to respond to shifting demand characteristics enables AT&T to be more efficient--a prime objective of price caps.

BellSouth believes that OCPs should remain in their own service category band. In the FNPRM, the Commission suggests including OCPs in the MTS service category because of the close substitutability of these services.¹¹ Except for anecdotal evidence, there is virtually no publicly available data that can be analyzed to determine the validity of the Commission's tentative conclusion.

For example, the AT&T "headroom" estimates that the Commission refers to are not supported by filed data. The

¹¹ FNPRM at ¶ 42.

only information that AT&T submits to the Commission are the index results, not the underlying data. Before the Commission makes any findings, it ought to have the benefit of the underlying data and sufficient information to independently verify AT&T's results.

At present, the Commission and the public operate in the dark with regard to the calculation of AT&T's price cap indices. A no more telling example of this inability to perform an informed review lies in AT&T's June 22, 1995, annual "non-filing" of the flow through of the LECs' annual access charge reductions.¹² By way of a letter, AT&T purports to adjust its price cap indices to reflect its share of the over \$1 billion in access charge reductions. All that AT&T provides the Commission is the results of its calculations and its statement that no rate adjustments are necessary. There is no way to verify AT&T's determination that only \$312 million of the total access charge reduction is associated with Basket 1 services. The index calculations must be accepted as matters of faith because none of the base period information is provided. The only verifiable fact from AT&T's letter is that not one penny of the \$1 billion in access charge reductions is finding its way to consumers of basic MTS services in the form of a rate reduction.

¹² See Letter from Mr. M. F. Del Casino, Administrator-Rates and Tariffs, AT&T, to Mr. William F. Caton, Acting Secretary, FCC dated June 22, 1995.

Of the numerous common carriers subject to price cap regulation, AT&T alone is permitted to ignore Section 61.49 of the Commission's rules. AT&T never provides nor is it required to provide sufficient information to calculate adjustments to its PCI, SBI or API.

At a minimum, the Commission should establish a "TRP"-like form for AT&T to submit each time it proposes a change that would affect the calculation of the indices. This would also include letter submissions made by AT&T such as its June 22, 1995, "annual" filing. By so doing, the Commission would establish a foundation upon which to test the substitutability of OCPs and the basic schedule services. If these data support combining of the two service category bands, then the Commission can always have an expedited proceeding to amend AT&T's price cap rules.

Without this data, however, it would be unwise public policy to combine the basic MTS schedule service category with OCPs. The fact that minutes of use associated with rate plans may be increasing does not address the number of users who are unaware of the existence of such plans or who are not targeted by AT&T as potential participants. Given the substantial decreases in access charges that have occurred and continue to occur, basic schedule MTS users too should benefit from these reductions. The efficiencies that AT&T gains from access reductions and price cap regulation should be realized equitably among all telecommunications

customers, not just those that are selected. Maintaining separate service categories for OCPs and basic MTS schedules will enable the Commission to meet its regulatory responsibilities and assure that the benefits of its regulatory plan are distributed to the widest scope of the consuming public.¹³

AT&T should be afforded the maximum flexibility consistent with the public interest for each of its service categories. BellSouth proposes that the Commission band the MTS service category with an upper price limit of 2% relative to the change in the PCI. There should be no lower price limit. In the past, the Commission has imposed downward pricing limits because of its fear that AT&T might engage in predatory pricing. Recent pricing actions by AT&T for its basic MTS schedule have been to increase rates. In the immediate past, there has not been any evidence of aggressive price reductions for basic MTS service. In the absence of such pricing behavior, the Commission's concerns regarding predation seem remote at best.

On the other hand, purchasers of service under the basic schedule do not seem to have received the benefit of the cost reductions AT&T has realized as a result of access charge reductions. Imposing a lower limit on basic MTS schedule prices could have a perverse effect and serve as

¹³ BellSouth is in agreement with the Commission's proposal to retain service category bands for (1) operator and credit card services and (2) international MTS.

regulatory excuse by AT&T not to lower rates. The absence of a lower limit, however, could have the salutary effect of encouraging rate reductions.

In the FNPRM, the Commission proposes to modify the new services rules as applied to APPs. As discussed above, BellSouth believes that establishing a new category, APPs, is inappropriate. Promotions ought to be treated in accordance with existing rules and associated with the service category for which the promotion is designed. To the extent that the Commission wishes to afford AT&T some additional flexibility to be more responsive to the marketplace, it could shorten the notice period for those promotions that are considered new services. Nevertheless, the promotion should be supported by an incremental cost showing.¹⁴

For the remaining service category bands, the upper price limit should be set at 5% relative to the change in PCI. To replicate a competitive market, there should be no lower limit associated with these service category bands.

If the Commission adopts BellSouth's proposals regarding service categories, band limits and flow through rules, then there is no need for a separate residential index. Instead of trying to overlay special rules that apply to the basic MTS schedule as the Commission seems to

¹⁴ The Commission should replace the net revenue test with an incremental cost test.

do in the FNPRM, BellSouth's proposals would put in place price cap rules that create incentives for AT&T to operate efficiently and assure that the widest scope of consumers share in the benefits of price cap regulation.


IV. CONCLUSION

In order for the Commission to insure that AT&T's price cap rules continue to achieve the Commission's objectives and serve the public interest, it must first reinforce the foundation of those rules by modifying the exogenous cost treatment of accounting rule changes and re-specifying AT&T's productivity factor. With these changes, the Commission can then modify the rules that pertain to Basket 1. BellSouth's proposals, if adopted by the Commission, would provide AT&T with additional flexibility that should increase efficiency of the price cap rules which in turn should inure to the benefit of consumers.

Respectfully submitted,

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